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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

PERIOD ENDED DECEMBER 31, 1990

PLEASE RETURN

MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

PERIOD ENDED DECEMBER 31, 1990

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APPOINTIVE OFFICIALS

Zoann Attwood, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION		TERM EXPIRES
Becky Erickson	Glasgow	January 1, 1993
Gary Rebal	Great Falls	January 1, 1994
Ward Shanahan	Helena	January 1, 1994
Bill Ware	Helena	January 1, 1993
Dwaine Iverson	Shelby	January 1, 1995

LOTTERY LIAISON COMMITTEE

Senator Ethel Harding	Polson
Representative Linda Nelson	Medicine Lake
Representative Norman Wallin	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(9), MCA, copies of this report must be distributed to the following individuals.

Stan Stephens, Governor

Bob Marks, Director, Department of Administration

Scott Seacat, Legislative Auditor

Joe Mazurek, President of the Senate

Hal Harper, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House have requested that this report be distributed to the Revenue Oversight Committee. In addition, the President of the Senate has requested this report be distributed to the Business and Industry Committee, the Education Committee, and the Finance and Claims Committee. The Speaker of the House has requested that this report be distributed to the specific members of the Business and Economic Development Committee and the Education and Cultural Resources Committee.

Members of the Business and Industry Committee are as follows:

J. D. Lynch, Chairman
Betty Bruske
Del Gage
Jerry Noble
Bob Williams
John "Ed" Kennedy, Vice Chairman
Eve Franklin
Tom Hager
Gene Thayer

Members of the Education Committee are as follows:

Chet Blaylock, Chairman
Bob Brown
Swede Hammond
Dick Pinsoneault
William Yellowtail
Harry Fritz, Vice Chairman
Bill Farrell
Dennis Nathe
Mignon Waterman

Members of the Finance and Claims Committee are as follows:

Judy Jacobson, Chairman	Greg Jergeson, Vice Chairman
Gary C. Aklestad	Tom Beck
Esther Bengtson	Don Bianchi
Gerry Devlin	Harry Fritz
Swede Hammond	Ethel Harding
Bob Hockett	Tom Keating
Richard Manning	Dennis Nathe
Larry Stimatz	Larry Tveit
Eleanor Vaughn	Mignon Waterman
Cecil Weeding	

Members of the Business and Economic Development Committee receiving the report are as follows:

Bob Bachini, Chairman	Sheila Rice, Vice Chairman
Bob Pavlovich	

Members of the Education and Cultural Resources Committee receiving the report are as follows:

Ted Schye, Chairman	Ervin Davis, Vice Chairman

March 25, 1991

Montana Lottery Commission:

The second quarter of fiscal year 1991 centered around focus group research and analysis for adding a small state-specific cash lotto-type game to the Montana Lottery's product line. This research was designed, among other things, to

- develop an optimal game configuration;
- estimate per capita increases from the addition of a new game; and
- determine the effects of cannibalization of existing games.

As anticipated, a decline in revenues and net transfer to the Office of Public Instruction was experienced during the quarter. However this decline was larger than expected mainly due to increased gas prices, the overall recession in the economy and the uncertainties generated by the actions in the Persian Gulf. Other lotteries have experienced similar declines in revenues.

It appears that this trend will continue through the third quarter of 1991 but we are hopeful that by the fourth quarter changes in the Lottery's product line will reverse this downward trend.

Zoann Attwood

Zoann Attwood
Director

MONTANA LOTTERY
BALANCE SHEET
DECEMBER 31, 1990

ASSETS	(Unaudited)
Cash	$ 176,638
Investment in Short-Term Investment Pool	906,500
Receivables (Net)	467,711
Inventories	189,651
Equipment	716,362
Other Fixed Assets	4,093
Accumulated Depreciation	(368,724)
Intangible Assets	285,911
Other Assets	72,027
TOTAL ASSETS	$ 2,450,169

LIABILITIES AND FUND EQUITY	
Liabilities:	
Accounts Payable and Accruals	$ 251,577
Lottery Prizes Payable	217,969
Due to Other Funds (Note 2)	1,465,841
Deferred Revenue	18,996
Installment Purchase/Lease Payable	70,760
Compensated Absences Payable (Note 1)	92,101
Allowance for Ticket Returns	332,925
	$ 2,450,169
FUND EQUITY:	
Retained Earnings Unreserved	-0-
Total Fund Equity	-0-
TOTAL LIABILITIES AND FUND EQUITY	$ 2,450,169

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PERIODS ENDED DECEMBER 31, 1990

	Quarter Ended December 31, 1990 (Unaudited)	Six Months Ended December 31, 1990 (Unaudited)
OPERATING REVENUES:		
Charges for Service		
Net instant ticket revenue	$ 1,383,748	$ 3,946,175
Net on-line ticket revenue	3,634,028	8,627,342
Other income	6,953	9,880
License and permits	500	2,550
Interest Earnings on STIP	11,225	19,923
Total Operating Revenues	$ 5,036,454	$ 12,605,870
Prizes and Commissions		
Instant ticket prize expense	(928,221)	(2,189,382)
On-line ticke prize expense	(1,635,313)	(3,882,304)
Retailer commission	(279,075)	(715,074)
Net Operating Revenue	$ 2,193,845	$ 5,819,110
OPERATING EXPENSES:		
Advertising	$ 144,815	$ 220,409
Amortization	51,186	102,373
Audit Fees	27,170	27,170
Communications	15,758	37,183
Contractual Services	48,743	104,863
Cost of tickets sold	91,516	246,004
Depreciation	31,437	63,790
Management Service Fee	20,428	29,932
On-line Vendor Fees	838,251	1,972,211
Other	3,867	47,868
Personal Services	242,647	473,304
Repairs and Maintenance	24,724	40,006
Supplies and Materials	15,320	22,887
Utilities and Rent	24,188	48,293
Travel	10,215	16,826
Total Operating Expense	$ 1,590,265	$ 3,453,119
Operating Income	$ 603,580	$ 2,365,991
NONOPERATING REVENUES (EXPENSES)		
Interest Expense	(30)	(99)
Total Nonoperating Revenues (Expense)	(30)	(99)
Income before Operating Transfers	603,550	2,365,892
Operating Transfers In (Out)	(603,550)	(2,365,840)
NET INCOME (LOSS)	$ -0-	$ 52
Retained Earnings, Beginning of Period (Note 5)		(52)
RETAINED EARNINGS, END OF PERIOD		$ -0-

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
COMPARATIVE STATEMENT OF ACTUAL
VS. BUDGETED REVENUES AND EXPENDITURES
PERIOD ENDED DECEMBER 31, 1990
(Unaudited)

	Budgeted Fiscal Yr. July 1,1990 - June 30, 1991	Actual Six Months Ended Dec. 31, 1990 (Unaudited)	Actual as a Percent of Budget (%)
OPERATING REVENUES:			
Charges for Services			
Net instant ticket revenue	$12,000,000	$ 3,946,175	32.88
Net on-line ticket revenue	14,500,000	8,627,342	59.50
Other income	-0-	9,880	N/A
License and permits	4,000	2,550	63.75
Interest Earnings on STIP	35,000	19,923	56.92
Total Operating Revenues	$26,539,000	$12,605,870	47.50
Prizes and Commissions			
Instant ticket prize expense	(6,360,000)	(2,189,382)	34.42
On-line ticket prize expense	(6,525,000)	(3,882,304)	59.50
Retailer Commission	(1,685,000)	(715,074)	42.44
Net Operating Revenue	$11,969,000	$ 5,819,110	48.62
OPERATING EXPENSES:			
Budgeted			
Advertising	$ 839,381	$ 220,409	26.26
Audit Fees	76,597	27,170	35.47
Communications	72,021	37,183	51.63
Contractual Services	271,513	104,863	38.62
Interest	119	99	83.19
Management Service Fees	82,762	29,932	36.17
On-line Vendor Fees	3,348,941	1,972,211	58.89
Other	57,219	47,868	83.66
Personal Services	1,005,742	473,304	47.06
Repairs and Maintenance	83,290	40,006	48.03
Supplies and Materials	47,475	22,887	48.21
Travel	41,366	16,826	40.68
Utilities and Rent	95,320	48,293	50.66
Nonbudgeted & budgeted with no expense			
Amortization	-0-	102,373	N/A
Cost of Tickets Purchased	607,126	-0-	N/A
Cost of Tickets Sold	-0-	246,004	N/A
Depreciation	-0-	63,790	N/A
Equipment	42,000	-0-	N/A
Installment Purchases	165,285	-0-	N/A
Total Operating Expenses	$ 6,836,157	$ 3,453,218	N/A
Operating Income	5,132,843	2,365,892	46.09
Retained Earnings, Beginning of Period		(52)	N/A
TRANSFER TO OPI	$ 5,132,843	$ 2,365,840	46.09

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
DECEMBER 31, 1990

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and prepare financial reports.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Investment in Short-Term Investment Pool. The Short-Term Investment Pool (STIP) is a pool of investments, maintained by the Montana Board of Investments, with maturities of one year or less. The Lottery's purchase of units in STIP totalled $906,500 as of December 31, 1990. These funds are highly liquid and may be purchased or sold daily. Interest earnings accrue daily and income is distributed monthly. Interest earnings for the quarter and six months ending December 31, 1990 totalled $11,225 and $19,923 respectively.

Receivables. Receivables totalling $467,711 represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts is usually based on historical perspective. Because of immaterial uncollectible account balances, an allowance for doubtful accounts has not been established.

Receivables include a $11,312 adjustment in retailer commissions related to estimated ticket returns.

Inventories. Inventories consist of merchandise, Instabuck and supplies inventories. Merchandise inventory includes lottery tickets valued at $180,984 stored in the warehouse and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. After game end and awaiting disposal, unsold tickets are charged to cost of tickets sold.

Merchandise inventory includes a $3,727 adjustment related to estimated ticket returns.

Supplies inventories include paper supplies, ticket dispensers, premiums and point-of-sale materials having a value of $5,000 or more. At quarter end, supplies inventories totaled $8,667. These inventories are also recorded at cost using the specific identification method.

Compensated Absences. State employees earn annual leave ranging from 15 to 24 days per year depending on the individual's years of service. Annual leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's payable for compensated balances is detailed below.

Balance June 30, 1990	Net Leave Earned/Used	Balance December 31,1990
$94,392	$2,291	$92,101

Allowance for Ticket Returns. This allowance represents a liability as of December 31, 1990 for estimated ticket returns. The allowance for ticket returns was increased by $316,149 from the quarter ending September 30, 1990. This is an estimate based, partially, on actual returns received after the end of the quarter. Conversely, ticket revenue has been decreased by approximately $316,149 for the quarter ended December 31, 1990. Prize expense has been decreased by approximately $130,689. Commissions and cost of goods sold have also been decreased for expenses associated with this change in allowance.

Revenue Recognition. Lottery instant ticket sales are recorded as revenue based on ticket deliveries to the retailers. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Lottery on-line ticket sales are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing.

Revenue From Other Sources. On November 1, 1990 the Lottery received $12,653 in settlement of an insurance claim filed with the Lottery's landlord's insurance agency. $5,700 of this was recognized as revenue at fiscal year end 1990 and the remaining $6,953 was recognized as revenue during the quarter ended December 31, 1990.

Other sources of revenue include the gain on sale of fixed assets totaling $2,927.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free tickets distributed approximated $268,830 for the quarter ended December 31, 1990.

Instabucks. Instabucks are a Lottery coupon good, upon redemption, for a lottery ticket. Instabucks, used to stimulate lottery ticket sales, are usually given away for promotions, retailer clerk incentive programs, and advertising trade-outs. The lottery tickets distributed resulting from Instabuck redemptions are reflected as a reduction in revenue. The related prize expense and ticket cost are reclassified as an advertising expense. For the quarter ended December 31, 1990, Instabuck redemptions resulted in a revenue reduction of $76,031 and a prize expense reclassification of $37,906.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. No prize expense is recorded for free tickets distributed.

Expenses for on-line prizes are recorded based on the predetermined prize structure for the on-line game.

Commissions. Section 23-5-1016(10), MCA provides retailers a commission on instant and on-line tickets or chances sold. The Lottery commission established this commission at 5% of the face value of instant tickets delivered to the retailers and on the amount of tickets sold for each on-line drawing. The commission on tickets sold to the retailer gives the retailer $15 per book of 300 tickets or 5 cents for each on-line ticket sold. The 5% commission of $268,132 and $672,989 for the quarter and six months ended December 31, 1990, is based on lottery tickets delivered to the retailer of 5,362,637 and 13,459,788.

Retailers can receive bonus commissions on tickets sold based on incremental sales of instant tickets. During the quarter and six months ended December 31, 1990, retailers earned bonus commissions totaling $10,943 and $42,085.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method. The Media Drop-In Productions, Inc. contract for the use of ten lottery advertisements, is also classified as an intangible asset. This contract is being amortized over a period of 3 years using the straight line method.

2. DUE TO OTHER FUNDS

The account "Due to Other Funds" totalling $1,465,841 reflects the balance of $862,290 payable to the State Superintendent of Public Instruction for the period ended September 30, 1990 and the $603,551 payable to the State Superintendent of Public Instruction for the period ended December 31, 1990.

3. PAID PRIZES AND PRIZE EXPENSE

Section 23-5-1027, MCA states "A minimum of 45% of the money paid for tickets or chances must be paid as prize money".

From October 1, 1990 through December 31, 1990 prizes paid are detailed as follows:

High-tier	$ 325,136
Low-tier	799,188
On-line	1,700,370
	$2,824,694

High-tier prizes reflect instant ticket prizes greater than $50 paid through Lottery headquarters. Low-tier prizes of $50 or less are paid by the retailer or Lottery headquarters.

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended December 31, 1990, the prize expense of $2,563,534 is 51.09% of net Lottery ticket revenue of $5,017,776. For the six months ended December 31, 1990, the prize expense of $6,071,686 is 48.29% of net Lottery ticket revenue of $12,573,517.

When recording the prize expense, a corresponding liability for high-tier prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

October 1 through December 31, 1990		Percent of Net Lottery Ticket Revenue (Unaudited)
Prizes paid	2,817,820	56.15
Instabucks	(37,916)	(.75)
Increase (decrease) in prize liability	(216,370)	(4.31)
Prize expense	$2,563,534	51.09

July 1 through December 31, 1990		Percent of Net Lottery Ticket Revenue (Unaudited)
Prizes paid	6,603,801	52.52
Instabucks	(54,939)	(.44)
Increase (decrease) in prize liability	(477,176)	(3.79)
Prize expense	$6,071,686	48.29

4. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

Section 23-5-1027, MCA states "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly from the enterprise fund to the State Superintendent of Public Instruction for distribution as equalization aid to the public schools of Montana..." Net revenue is that part of all gross revenue not used for the payment of prizes, commissions and operating expenses. Net revenue for the quarter and six months ended December 31, 1990, is $603,550 and $2,365,840.

5. DEFICIT RETAINED EARNINGS

According to the law, the Lottery's net revenue must be transferred quarterly to the State Superintendent of Public Instruction. This transfer should result in a zero retained earnings balance. Because of recording a fiscal year

1989-1990 expenditure after calculation of the transfer for the quarter ending June 30, 1990, the beginning retained earnings balance is ($52) rather than zero.

6. PRIZE RESERVE FUND

As a member of the Multi-State Lottery Association (MUSL) and the Lotto*America game, the Lottery is required to contribute to a prize reserve fund maintained by MUSL. This fund is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund, as well as the interest earned on the Lottery's share of the fund, would be returned to the Lottery upon leaving MUSL (assuming that no unanticipated prize claims have been paid).

The Lottery contributes to the reserve fund through the 45% set-aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve fund accumulated since the start of the Lotto*America game. The Lottery made this payment in full as of June 1990, through an additional 2% of drawing revenue rather than making a lump sum payment. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game. Contributions to this fund total $399,301, interest earnings equal $48,081 for a total of $447,382 as of December 31, 1990.

7. GAMES

Currently, the Montana Lottery games are instant ticket games and an on-line game referred to as Lotto*America. Instant ticket games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize. The Lotto*America game allows players the chance to win a minimum jackpot of $2 million. Players select 6 numbers from a field of 54 and must match at least 4 out of 6 to win a prize. Drawings are held twice weekly on Wednesday and Saturday nights. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

8. GAMING SUPPLIER CONTRACTS

Tickets. On March 9, 1990, the Montana Lottery entered into a one year contract with Dittler Brothers, Inc. to purchase lottery tickets.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. The contract requires payment within 30 days of ticket receipt.

Dittler Brothers, Inc., as the vendor, delivered a $500,000 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $4,500,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Dittler Brothers, Inc.

Computer Hardware and Software. The Lottery contracted with Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Uninterruptable Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed a second agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the Instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, nonexclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June, 1987.

Under the Extension and Second Amendment of Instant Ticket Contract dated January 5, 1989, these monthly payments were reduced to $11,672.22 commencing with the November 1988 payment. Upon expiration or termination of the Instant Ticket Contract with Scientific Games, Inc. on March 8, 1990, the payments were reinstated to $23,344.44 until the balance is paid in full.

On-line Services. On August 30, 1989, the Lottery selected Control Data Corporation to provide on-line terminals, central computers, telecommunications network, and training for a five year period. The contract, with an effective date of November 9, 1989, provides that payment will be a percentage of sales, which for the first year of the contract will be 25% of the first $250,000 of weekly sales, and 19% for sales between $250,001 to $500,000. The percentage decreases with higher weekly sales.

On November 9, 1990, the Lottery and Control Data Corporation entered into the second year of the on-line contract. Payment during the second year of the contract is based on 22% of the first $500,000 of weekly sales. This percentage decreases with higher weekly sales.

Control Data Corporation delivered a $1,980,000 performance bond covering the second year of the contract.

9. PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totalling $5,000,000. The Lottery made the initial payments to the winners in the amount of $253,088 and on September 26, 1988, the Montana Lottery awarded annuities in the amount of $2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of December 31, 1990, the contingent liability for future prize payments funded through the purchase of annuities was $4,035,147.

10. LOTTO*AMERICA JACKPOT PRIZES

Jackpot prizes awarded in the Lotto*America game are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the State of Montana for the Montana Lottery by MUSL. MUSL will cash the bonds each year as they mature and will wire the funds to the Lottery for payment to winners on the anniversary date of the win.

On January 13, 1990, the Montana Lottery awarded its first Lotto*America jackpot prize totalling $1,740,000. The first annual payment of $87,000 was made on February 1, 1990. On May 9, 1990, the Lottery awarded a second Lotto*America jackpot prize of $3,000,000. The first annual payment of $150,000 was made on May 23, 1990. As of December 31, 1990, the contingent liability for future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds was $4,503,000.